

This record is a partial extract of the original cable. The full text of the original cable is not available.

C O N F I D E N T I A L SECTION 01 OF 04 ANKARA 007311

SIPDIS

STATE FOR E, EUR/SE AND EB
TREASURY FOR OASIA - MILLS AND LEICHTER
STATE PASS USTR FOR NOVELLI/ERRION
USDOC FOR 4212/ITA/MAC/OEURA/DDEFALCO
USDA FOR FAS FOR EC AND CCC/FSA

E.O. 12958: DECL: 11/21/2008
TAGS: [ECON](#) [PREL](#) [EFIN](#) [EINV](#) [TU](#)
SUBJECT: SCENESETTER FOR THE ECONOMIC PARTNERSHIP
COMMISSION MEETING

REF: ANKARA 7121

(U) Classified by DCM Robert Deutsch. Reason: 1.5 (b).

1. (C) Summary: A successful EPC will help our efforts to strengthen a bilateral relationship that has been through difficult times this year. Two developments -- the still-fragile recovery of the Turkish economy, and the development of economic opportunities in Iraq -- should create opportunities for stronger economic ties, if managed properly. There has been less progress on the trade and investment front, despite Turkish steps to improve the investment environment. Energy has been a mixed bag, with continued cooperation on regional efforts but little progress in reform of Turkey's domestic market. PM Erdogan hopes the EPC will rejuvenate the QIZ initiative; otherwise, GOT expectations appear relatively low.

The Context

2. (C) The second Economic Partnership Commission meeting comes at the end of a difficult year in U.S.-Turkish relations and in the immediate aftermath of terrorist attacks that have shaken Turkey. Prime Minister Erdogan told the Ambassador November 15 that he sees the meeting, along with the just-completed High Level Defense Group discussions, as evidence that the bilateral relationship is recovering from recent travails. In that broad sense, a successful EPC can add to the positive momentum in the overall relationship.

3. (C) Our ability to stage a successful EPC meeting should be aided by the fact that, so far at least, Turkish expectations are lower than they were in the lead-up to the February 2002 meeting. Prime Minister Erdogan hopes the meeting will rejuvenate the Qualified Industrial Zone initiative, and the Turks in general want extensive discussions on Iraq. Beyond these issues, however, the GOT has not articulated specific goals for the meeting.

4. (SBU) Reftel suggests goals and issues for discussion for each segment of the EPC. This cable provides an overview of the state of the relationship in these areas.

The Economic Relationship

5. (SBU) Economic Reform: After a rocky start, the AK Government has presided over positive economic developments since April. Turkey is now poised to meet its year-end macro targets: 5 percent real GDP growth, a 6.5 percent primary surplus, and 20 percent inflation--the lowest rate since the 1970s. Foreign exchange, equity and debt markets have enjoyed a sustained rally.

6. (SBU) The GOT's success in meeting macroeconomic targets in recent months stems only partly from its economic policies. Though the GOT has broadly cooperated with the IMF and shown a commitment to fiscal discipline, it also benefited from the Iraq war having much less impact on Turkey's economy than expected, from lower inflation achieved by the independent Central Bank and from the lira appreciation induced by reverse currency substitution in the markets.

7. (SBU) Senior officials have yet to demonstrate support for the structural reforms that are essential to Turkey achieving sustained growth. On privatization, the GOT will end 2003

with unsatisfactory results, having cancelled two major tenders. The GOT has moved slowly on liberalization of the agriculture, telecoms and energy sectors, and has not supported the independent regulatory boards. Though it claims it is re-energizing its dialogue with the World Bank on structural reforms, the government has yet to take meaningful actions outside of the narrow range of reforms required by the IMF program.

18. (SBU) Some analysts fear that the GOT's laxity in implementing structural reforms, combined with a growing current account deficit and a sense that markets may have overshot in a positive direction, could leave financial markets vulnerable to a sharp downturn at some point in 2004.

Trade

19. (SBU) With some isolated exceptions (such as passage of modern copyright legislation in 2001), there has been little progress on outstanding issues in our bilateral trade relationship in recent years. The USG has repeatedly pressed for the elimination of WTO-inconsistent restrictions on agriculture imports, stronger intellectual property protection, and an end to policies that discriminate against imported drugs. The Turks respond that the USG maintains significantly higher tariff and non-tariff barriers (including textile/apparel quotas and anti-dumping, countervailing duty actions) on Turkey's products overall than they do on ours.

110. (SBU) Our trade with Turkey is approximately balanced, with each country exporting about USD 3 billion in goods to the other annually. Turkey's exports are highly concentrated in sensitive sectors such as textiles, apparel and steel, which face higher-than-average levels of protection.

111. (SBU) Turkey sharply cut its industrial tariffs on third countries to just over four percent under the EU customs union. Although Turkey did this unilaterally to obtain the benefits of duty-free access to European markets, the Turks argue that they made trade concessions to the United States and others without compensation in the form of better access for Turkish products. This is a bogus argument, but one they continually make.

112. (SBU) Turkey's relatively low current industrial tariffs are one ingredient in Turkey's ambivalent approach to the WTO talks. The GOT is hesitant to endorse multilateral liberalization in industrial goods that would erode the benefit to Turkey of duty-free access to the EU market. It is also wary of tariff reductions in agriculture, maintaining that high tariffs are Turkey's only tool to protect its agricultural producers from highly-subsidized EU and U.S. imports. In the WTO talks, Turkey insisted with the G-21 on elimination of these subsidies and proposed asymmetrical tariff reductions on industrial goods.

113. (SBU) The Prime Minister has indicated he wants to move forward on Qualifying Industrial Zones for Turkey at the EPC, but we do not yet know what the Turks will say on this subject at the meeting. Foreign Trade officials are skeptical that companies from eligible sectors could both satisfy QIZ requirements (primarily Israeli content) and derive a trade benefit (since many if not most of the sectors with the highest tariffs would be excluded).

Investment

114. (SBU) Turkey has underperformed many other emerging markets in attracting foreign direct investment, with inflows well under one percent of GDP for most of the last decade. The Erdogan Government is more receptive to FDI and private sector concerns than were its predecessors, and has taken steps to improve the climate for FDI, including a law ending screening of foreign investors and another streamlining company establishment. Inflation accounting--long sought by investors--is due to come into effect January 1, 2004. The GOT is also considering establishment of a public-private agency to promote investment in Turkey. The GOT has taken a few helpful steps for individual U.S. companies, such as authorizing higher quotas for corn syrup producers under the Sugar Law.

115. (SBU) Notwithstanding these actions, U.S.--and other foreign-- companies continue to face a difficult business environment. This affects large multinationals, like Motorola, Cargill, Pfizer and the other pharmaceuticals companies, and small business persons like Victor and Kristy Bedoian, who have struggled for several years to operate a

hotel they renovated in Van. Other policies) like the failure to honor contract sanctity on build-operate-transfer (BOT) projects in energy or the lack of data exclusivity protection) send a negative signal about the GOT,s willingness to adhere to agreements previously undertaken.

16. (SBU) We have pressed the GOT at high levels to solve these issues prior to the EPC. Thus far, our GOT interlocutors have provided few clues as to what they may be prepared to do in this area in the near future.

Energy

17. (SBU) Regional energy cooperation has been a success story. We have worked closely and effectively with Turkey to begin building the Baku-Tbilisi-Ceyhan oil pipeline and to attain sanctioning of the Shah Deniz natural gas pipeline. Both projects are proceeding, albeit with some delays on BTC. The Turks are concerned that Washington has lost interest in these projects, considering them done. They also are worried about the possible impact of political developments in the Caucasus on the pipelines and about the possible reversal of Odessa-Brody. Although Turkey is committed to Shah Deniz, prospects for a significant natural gas surplus over the next several years could affect Turkey,s decision making unless potential markets are identified in Europe for the surplus.

18. (SBU) On the domestic front, the Energy Regulatory Market Authority (EMRA) has made substantial progress in implementing both the Natural Gas Law and the Electricity Law and aligning Turkey with the EU,s acquis; however, much more needs to be done to establish a liberalized market. The credibility of the deregulation program is at stake unless BOTAS and the state generation and trading companies comply with EMRA,s regulations, especially to establish a tariff system and to end BOTAS,s gas market monopoly.

19. (SBU) The other major domestic issue concerns the GOT,s treatment of U.S. energy investors. First, the government decided not to implement a number of Build-Operate-Transfer (BOT) and Transfer of Operation Rights (TOR) projects, including several involving U.S. firms, despite having signed contracts with those firms. More recently, the government has been pressing existing BOT companies*including two involving major U.S companies*to lower tariffs unilaterally. In addition to the U.S. private investment in these projects, OPIC and Eximbank have provided financing. The Energy Minister has publicly threatened to take over the companies, and has said that they should not rely too much on their contracts. Moreover, the government has launched several investigations into the projects, which the companies believe constitutes a form of harassment.

Regional Cooperation

20. (SBU) Turkey continues to assert itself as a force for stability in the region. Turkey,s efforts derive from its own view of how best to contribute, and in many areas, such as Afghanistan and the East-West Energy Corridor, it has enthusiastically followed the U.S.

21. (SBU) Afghanistan: Turkey has already disbursed its \$5 million Tokyo pledge and hopes to increase its pledge even more. Turkish companies are also playing a significant role in reconstruction efforts.

22. (SBU) Iraq: In Madrid, Turkey pledged \$50 million for Iraq Reconstruction. Turkey has also made numerous offers to help with humanitarian needs. Turkey provides a vital overseas corridor for supplies for U.S. troops in Iraq, as well as humanitarian supplies and fuel. In addition, Turkey has begun exporting electricity to Iraq and plans to significantly increase exports to help fill Iraq,s urgent power deficit.

23. (SBU) Several Iraq-related items remain on the agenda: timing of the re-opening of the Kirkuk-Yumurtalik oil pipeline; mechanisms to enhance Turkish-Iraqi trade, including Turkey's desire to open a second border gate, ways to reduce delays in getting supplies through Habur Gate, and Turkey's interest in revitalizing Turkey-Iraq rail links; projects -- proposed by U.S. companies AIG and Washington International Group ---to increase the capacity of Turkey-Iraq electricity transmission lines; our request that the Turkish Export-Import Bank negotiate an agreement with the Iraqi Trade Bank (along the lines of U.S. Ex-Im's agreement); Ziraat Bank's interest in establishing branches in Iraq; and of course the great interest of Turkish companies in obtaining Iraqi reconstruction contracts.

124. (SBU) Caucasus: Turkey is an essential partner in the BTC project and the East-West Energy Corridor that will bolster the economies of Georgia and Azerbaijan and provide a new oil supply to world markets.

125. (SBU) Water to Israel: Turkey hopes that reducing water tensions in the Mideast will contribute to peace. It is negotiating with Israel a plan to send by tanker 50 million cubics meters of fresh water per year and has made the same offer to other Mideast countries.

EDELMAN